

Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 ICA-11 AID-05 EB-08 NSC-05
TRSE-00 SS-15 STR-07 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PA-01 /096 W
-----030201 070516Z /20

R 070352Z APR 78
FM AMEMBASSY PARIS
TO SECSTATE WASHDC 9729
AMEMBASSY BELGRADE

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E.O. 11652: N/A
TAGS: OECD, ECON, YO
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC): REVIEW OF YUGOSLAVIA, APRIL 10, 1978

REF: EDR(78)8 AND ANNEXES

1. RECENT TRENDS AND POLICY: ACCORDING TO SECRETARIAT ANALYSIS, THE POLICIES APPLIED IN 1977 PRODUCED QUITE SATISFACTORY RESULTS IN TERMS OF INCREASES IN OUTPUT, INVESTMENT, EMPLOYMENT AND PRODUCTIVITY. BUT THE INFLATION RATE REMAINED UNCOMFORTABLY HIGH AND THE CURRENT BALANCE OF PAYMENTS DETERIORATED APPRECIABLY, DUE PARTLY TO THE SLOW EXPANSION OF WORLD TRADE. THE SHORT-TERM OUTLOOK SUGGESTS THAT IT WILL BE DIFFICULT TO MEET SIMULTANEOUSLY ALL MAJOR TARGETS THAT ARE LAID DOWN IN THE 1978 POLICY RESOLUTIONS AND THE QUESTION, THEREFORE, ARISES AS TO WHETHER AND IN WHICH AREAS THE PRESENT POLICY STANCE MAY HAVE TO BE MODIFIED. IF THE ECONOMY CONTINUED TO EXPAND MUCH FASTER THAN OTHER COUNTRIES--
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ESPECIALLY IN WESTERN EUROPE--THE EXTERNAL DEFICIT WOULD BE SUBJECT TO CONSIDERABLE UPWARD PRESSURE. IN 1977, IT AMOUNTED TO SOME 4 PERCENT OF GNP AND ITS FINANCING DID NOT RAISE MAJOR PROBLEMS, BUT SOME REDUCTION IS NOW EVIDENTLY DESIRABLE. SUBORDINATION, TO SOME EXTENT, OF THE GROWTH OBJECTIVE TO THE BALANCE OF PAYMENTS CONSTRAINT APPEARS INEVITABLE IN 1978, AND POS-

SIBLY BEYOND. DAMPENING OF DOMESTIC DEMAND GROWTH BELOW OFFICIAL TARGETS SEEM NECESSARY SIMPLY TO KEEP THE RISE IN THE TOTAL IMPORT BILL WITHIN REASONABLE LIMITS AND TO INCREASE THE INCENTIVE TO EXPORT. THE OBVIOUS CANDIDATE FOR SUCH A MEASURE IS PRIVATE CONSUMPTION, WHICH HAS AN APPRECIABLE IMPORT CONTENT AND, CONTRARY TO MEDIUM-TERM AIMS, GREW QUICKLY AS SOCIAL PRODUCT IN 1976 AND 1977. AS THE TREND IN CONSUMER DEMAND HAS BEEN WEAKER SINCE THE LATTER PART OF 1977, A RE-ENFORCEMENT OF RESTRICTIONS ON CONSUMER CREDIT WOULD HELP TO KEEP CONSUMPTION GROWING AT A MODEST RATE AND AT THE SAME TIME DAMPEN COST OF LIVING INCREASES WHICH HAVE RECENTLY BEEN DISTURBINGLY HIGH. IF OVERALL GROWTH IS TO BE REDUCED WITH INVESTMENT BEING GIVEN PRIORITY OVER CONSUMPTION, IT IS ALL THE MORE IMPORTANT THAT THE INVESTMENT TAKES PLACE IN AREAS WHERE THE REAL RATE OF RETURN PROMISES TO BE HIGHEST. IN THE PAST, THIS HAS NOT INVARIABLY BEEN THE CASE. WITH INCREASED DECENTRALIZATION OF THE DECISION-MAKING PROCESS, THE INTEREST RATE SHOULD BE ALLOWED TO PLAY AN INCREASING ROLE IN THE ALLOCATION OF INVESTIBLE FUNDS. RECENT POLICY MOVES TO LOWER NOMINAL INTEREST RATES APPEAR INCONSISTENT WITH THIS, IN THE FACE OF PERSISTENTLY HIGH RATES OF INFLATION AND A STRONG UNDERLYING PROPENSITY TO INVEST.

2. COMPETITIVE POSITION: EXPERIENCE SHOWS THAT, EVEN LIMITED OFFICIAL USE

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WITH MORE MODERATE GROWTH OF DEMAND AND OUTPUT, SIGNIFICANT COST AND PRICE PRESSURES ARE LIKELY TO PERSIST. THERE ARE, INDEED, SIGNS OF SOME EROSION IN THE ECONOMY'S EXTERNAL COMPETITIVENESS OVER THE LAST FEW YEARS. RESORT TO SPECIFIC MEASURES OF EXPORT PROMOTION AND IMPORT RESTRAINT CANNOT BE A SATISFACTORY PERMANENT SUBSTITUTE TO A REALISTIC AND FLEXIBLE EXCHANGE RATE POLICY. BUT HOWEVER NECESSARY A CORRECTION OF THE PROBLEM OF DISTORTIONS BETWEEN DOMESTIC AND FOREIGN PRICES MAY BE, UNDERLYING INFLATIONARY PRESSURES WILL REMAIN STRONG AS LONG AS NOMINAL INCOMES CONTINUE TO INCREASE VERY MUCH FASTER THAN OVERALL PRODUCTIVITY. SOME OF THE INSTITUTIONAL CHANGES INTRODUCED IN RECENT YEARS AIMED AT SLOWING DOWN EXORBITANT INCREASES OF WAGES; AND OTHER MEASURES MIGHT BE CONSIDERED, INCLUDING MORE PROGRESSIVE RATE OF TAXATION OF PERSONAL INCOMES. HOWEVER, THE MORE IMPORTANT ELEMENT OF AN APPROPRIATE INCOMES POLICY MAY WELL BE THE DEVELOPMENT OF A GENERAL CONSENSUS ABOUT THE RISKS OF

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COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PA-01 /096 W
-----030251 070516Z /20

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OF PERMANENT DOUBLE-DIGIT INFLATION. THE ALTERNATIVE
SOLUTION OF PROLONGED DEFLATIONARY POLICIES IS PARTICULARLY UNACCEPTABLE FOR COUNTRIES IN THE PROCESS OF INDUSTRIALIZATION THAT NEED HIGH RATES OF GROWTH TO COPE WITH SERIOUS EMPLOYMENT PROBLEMS.

3. EMPLOYMENT AND INVESTMENT POLICY: YUGOSLAVIA'S
GROWTH AND EMPLOYMENT PERFORMANCE SINCE THE EARLY 1970'S
HAS BEEN GOOD ON THE WHOLE DESPITE UNFAVORABLE EXTERNAL
CONDITIONS--NOTABLY THE OIL PRICE INCREASE, THE WORLD
RECESSION AND ITS AFTERMATH AND THE REVERSAL OF EARLIER
EMIGRATION FLOWS TO INDUSTRIALIZED EUROPEAN COUNTRIES.
THE COMBINATION DURING THIS PERIOD OF HIGH EMPLOYMENT
AND INVESTMENT GROWTH IN THE SOCIALIZED AND THE PRIVATE
NON-FARM SECTORS HAS HAD FAVORABLE EFFECTS ON THE LEVEL
OF OVERALL LABOR AND CAPITAL PRODUCTIVITY AND ALSO ON
AVERAGE PER CAPITA REAL INCOME. GIVEN THE STILL ABUNDANT
UNDERUTILIZED LABOR RESOURCES, THE POSSIBILITY OF FURTHER
SUBSTANTIAL SHIFTS IN THE STRUCTURE OF EMPLOYMENT BETWEEN
LOW-AND HIGH-PRODUCTIVITY SECTORS OF THE ECONOMY WILL
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REMAIN ONE OF THE MAJOR FUTURE SOURCES OF POTENTIAL
GROWTH. A CONSIDERABLE NUMBER OF NEW JOBS COULD BE

CREATED IN LABOR-INTENSIVE BRANCHES LIKE HOUSEBUILDING, HANDICRAFT AND PRIVATE SERVICES WHICH THE MEDIUM-TERM PLAN INTENDS TO PROMOTE AND WHICH WILL CERTAINLY BE FACED WITH RISING DEMAND AS A RESULT OF INCREASING STANDARDS OF LIVING. THERE ARE ALSO SIGNIFICANT POSSIBILITIES FOR DEVELOPMENT OF CERTAIN LABOR-INTENSIVE TYPES OF PRIVATE AGRICULTURAL PRODUCTION. FAST ECONOMIC GROWTH WILL REQUIRE, NEVERTHELESS, A HIGH RATE OF PRODUCTIVE INVESTMENT IN THE SOCIALIZED SECTOR. THE PRESENT STRUCTURE OF EMPLOYMENT AND THE VERY HIGH RATE OF REGISTERED JOB-SEEKERS WARRANT GIVING HIGH PRIORITY TO CAPACITY-WIDENING INVESTMENT. ACHIEVEMENT OF MEDIUM-TERM GOALS, HOWEVER, WILL DEPEND IN YUGOSLAVIA AS IN OTHER "LABOR-SURPLUS COUNTRIES" NOT ONLY ON APPROPRIATE DOMESTIC POLICIES BUT ALSO ON A SUFFICIENT EXPANSION OF DEMAND IN THE MAJOR INDUSTRIALIZED COUNTRIES AND ON THE FREE DEVELOPMENT OF WORLD TRADE.

4. MISSION COMMENTS:

(A) YUGOSLAV MEMORANDUM TO EDRC CITES PROTECTIONIST MEASURES OF OECD COUNTRIES AS PRINCIPAL CAUSE OF EXPORT WEAKNESS, WHEREAS SECRETARIAT EMPHASIZES LOSS OF COMPETITIVE POSITION DUE HIGH COSTS AS MAJOR FACTOR, WHILE ACKNOWLEDGING SOME DETRIMENTAL EFFECTS FROM OECD COUNTRY TRADE RESTRICTIONS. MISSION BELIEVES IT WOULD BE USEFUL TO DISCUSS EXTENT TO WHICH THESE TWO FACTORS ARE INVOLVED AND WHICH IS MORE SIGNIFICANT, ESPECIALLY SINCE COST PRESSURES ARE MORE SUSCEPTIBLE TO YUGOSLAV POLICY. NEW ARRANGEMENTS FOR EXPORT PROMOTION FUNDS, WHICH SECRETARIAT BELIEVES MAY HAVE EFFECT OF EXPORT SUBSIDIES, LIMITED OFFICIAL USE

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ALSO RELEVANT.

(B) SECRETARIAT DRAWS ATTENTION TO POTENTIAL RESOURCE MISALLOCATION OF INVESTMENT RESOURCES IN YUGOSLAVIA AS INVESTMENT DECISIONS ARE INCREASINGLY DECENTRALIZED, WHILE COST OF CAPITAL FUNDS (REAL INTEREST RATE) IS NEGATIVE. DOCTRINAL QUESTIONS ASIDE, MISSION WOULD BE INTERESTED IN HOW INVESTMENT PROJECTS WILL BE EVALUATED IN SITUATION OF PERPETUAL EXCESS DEMAND FOR CAPITAL FUNDS.

5. MISSION NOTES RECENT CABLE TRAFFIC ON EC/YUGOSLAV NEGOTIATIONS AND EFFORTS TO LIBERALIZE YUGOSLAV TRADE POLICIES. GIVEN POINT RAISED IN PARA 4(A) AND SECRETARIAT'S RECOMMENDATION THAT YUGOSLAVIA HOLD DOWN CONSUMER IMPORTS, IT WOULD NOT SEEM TO BE AN APPROPRIATE MOMENT TO PURSUE YUGOSLAV LIBERALIZATION IN THE EDRC.

MISSION WOULD PARTICULARLY APPRECIATE EMBASSY AND WASHINGTON COMMENTS ON THIS TOPIC.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC DEVELOPMENT, POLICIES, COMMITTEES, ECONOMIC TRENDS
Control Number: n/a
Copy: SINGLE
Draft Date: 07 apr 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978PARIS11458
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780150-0118
Format: TEL
From: PARIS USOECD
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780481/aaaacqme.tel
Line Count: 227
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 05fe34b4-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3041071
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC): REVIEW OF YUGOSLAVIA, APRIL 10, 1978
TAGS: ECON, YO, OECD
To: STATE BELGRADE
Type: TE
vdkgvwkey: odb://SAS/SAS.dbo.SAS_Docs/05fe34b4-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014